

Minneapolis Community Development Agency

## Request for City Council Action

Date: April 8, 2003

To: Council Member Lisa Goodman, Community Development Committee  
Council Member Barbara Johnson, Ways and Means/Budget Committee  
Refer to: MCDA Board of Commissioners

Prepared by Phil Handy, Phone 612-673-5010

Approved by Lee Sheehy, MCDA Executive Director  
Chuck Lutz, MCDA Deputy Executive Director \_\_\_\_\_

**Subject: Target Center Capital Improvement Program Financing  
5% Private Payment Exemption**

**Previous Directives:** On March 10, 1995, the City Council and Board of Commissioners approved the terms and authorized the execution of the Target Center Purchase Agreement, related lease and financing documents, and the issuance of \$84,650,000 in tax exempt bonds. Included in the terms of the documents, and as a condition of the tax exempt financing, is the obligation of MCDA as owner of Target Center to undertake and pay for certain types of Capital Improvements and the prohibition of the private entities from doing so without the prior written approval of the MCDA.

**Ward:** 5

**Neighborhood Group Notification:** N/A

**Consistency with *Building a City That Works*:** Goal 4: Preserve and enhance the historic structures, urban institutions, environments, and amenities that define Minneapolis; Strategy 1: Oversee management and maintenance of publicly-owned entertainment venues.

**Comprehensive Plan Compliance:** N/A

**Zoning Code Compliance:** N/A

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**Impact on MCDA Budget:** (Check those that apply)

- ☐ No financial impact
- ☐ Action requires an appropriation increase to the MCDA Budget
- ☐ Action provides increased revenue for appropriation increase
- ☐ Action requires use of contingency or reserves
- ☒ Other financial impact (Explain): Approval will allow some capital improvements to be financed privately that otherwise would have to be paid from the Target Center Capital Improvements Fund.

**Living Wage / Business Subsidy:** N/A

**Job Linkage:** N/A

**Affirmative Action Compliance:** N/A

**RECOMMENDATION:**

**City Council Recommendation:** The Deputy Executive Director recommends that the City Council authorize MCDA staff to permit privately financed capital improvements for Target Center provided:

- (1) Each improvement project receives prior approval by the Executive Director.
- (2) The present value of all "private payments" and "private loan payments" within the meaning of Section 141 of the Internal Revenue Code of 1986, as amended, related to such improvement projects does not exceed five percent of the original principal amount of the 1995 City and Agency Arena Acquisition Bonds for the life of said Bonds, such amount to be determined by qualified bond counsel.
- (3) The City Finance Officer approves the administrative and accounting procedures to be used in authorizing and monitoring such projects and
- (4) Forward to the MCDA Board of Commissioners.

**MCDA Board Recommendation:** The Deputy Executive Director recommends that the MCDA Board authorize MCDA staff to permit privately financed capital improvements for Target Center provided:

1. Each improvement project receives prior approval by the Executive Director.
2. The present value of all "private payments" and "private loan payments" within the meaning of Section 141 of the Internal Revenue Code of 1986, as amended, related to such improvement projects does not exceed five percent of the original principal amount of the 1995 City and Agency Arena Acquisition Bonds for the life of said Bonds, such amount to be determined by qualified bond counsel. and
3. The City Finance Officer approves the administrative and accounting procedures to be used in authorizing and monitoring such projects

### **Background/Supporting Information**

As a condition for maintaining the tax exempt nature of the bonds issued by the City and MCDA for the Target Center acquisition in 1995, the MCDA, as fee owner of the facility, must undertake and pay for certain types of capital improvements and equipment purchases. The various leases and related documents with SFX/Clear Channel ("Manager"), Minnesota Timberwolves ("Team"), and Northwest Athletic Club ("Health Club") require that all proposed capital projects be submitted through Manager to MCDA for determination as to whether they must be done by MCDA pursuant to the bond restriction. The documents also define the contractual obligations of MCDA to pay for certain capital improvements: (a) structural integrity requirements; (b) those necessary for the arena to be open to the public for the uses originally intended; (c) scoreboard replacement.

The Target Center Capital Improvement Program is funded through the public revenues that comprise the Target Center Finance Plan. As approved in 1995, these revenues consisted of Target Center tax increment (and City share of the base taxes), City Entertainment Tax from Target Center events, payments from the Minnesota Amateur Sports Commission (dependent on annual appropriation), and Parking Fund allocations. Earlier this year, due to the drastic reduction in project tax increment attributable to the State reduction in tax classification rates and exclusion of the State Education Tax Levy from tax increment, the Finance Plan was amended to include allocations from the Common Project. If, in any year, these "pledged" revenues exceed certain priority expenditures (primarily bond debt service), then an allocation to the Target Center Capital Improvements Fund must be made up to an annual maximum amount defined by a schedule to the agreements. Currently, and through 2010, this annual amount is \$500,000.

So far, the annual allocations to the Capital Improvements Fund have enabled us to keep up with the basic required capital improvements relating to structural and mechanical integrity and life safety items. However, we have not been able to accrue a reserve sufficient to address major items such as seating or scoreboard replacement, or to respond to requests from the Team or Manager for arena enhancement projects to keep Target Center more competitive with newer arenas and event attendee expectations. This has made it difficult to implement projects that a private entity is willing to finance, but requires a "capital improvement" component that we are unable to fund. For example, converting a storage area to a retail or concession facility might be largely financed by the vendor as tenant improvements, but requires modifications to the plumbing or HVAC systems that are capital improvements.

### **5% Private Payment Exemption Rule**

The Internal Revenue Code of 1986, as amended, (the "Code") sets the regulations regarding eligibility for tax exempt financing. Sections 141(b)(2) and 141(c) of the Code set forth a "private security or payment test" and "private loan financing test" which impose limits on the capital improvements that may be made to the Target Center by nongovernmental parties. If the limits imposed by such tests are exceeded, interest on the bonds could become subject to federal income taxation. Having a private entity pay for or finance a qualified capital improvement with respect to Target Center would be considered a "private payment" or "private loan payment" by the Code. City Bond Counsel has advised staff that, provided the cumulative total of such private payments and financing over the thirty-year life of the bonds is less than five percent of the original principal amount of the bonds, such payments would not cause the bonds to become taxable. For the \$84,650,000 1995 Target Center bonds (the "Bonds"), this cumulative cap would equal approximately \$4,200,000. Further, each "private payment" amount can be discounted at the yield on the Bonds back to the date of issuance. Therefore, the later in the term of the Bonds that a payment is received or incurred, the less impact it would have in reducing the cumulative cap.

During the structuring of the 1995 arena acquisition, the City decided not to rely on any "private payment" exemption as part of the Finance Plan. Absent a specific advance ruling, the Code is subject to interpretation and to IRS audit. Given the complexity of the facility, financing, and contractual arrangements, the exemption was considered a cushion against audit findings contrary to our determination of what expenditures would apply to the exemption cap. After eight years of administering the capital improvement program with the participation of Manager, Team, Health Club, bond counsel, and our designated facility architect, we have much more experience in making such determinations. It was also believed that the Financing Plan provided adequate revenues to finance needed capital improvements over the life of the bonds. With the reduction in revenues discussed above and the opening of a new arena in St. Paul, the ability of MCDA to finance "arena enhancement" improvements that would keep Target Center competitive for events has become increasingly difficult. However, several of these enhancement improvements have the capacity to generate significant revenues or are so important to customer satisfaction that the private entities may want to finance them in whole or in part, if they would be permitted to do so.

### **Staff Recommendation**

Given the reduced capacity of the MCDA's Target Center Capital Improvements Fund and the critical need to undertake certain revenue producing or arena enhancement improvements to Target Center, it is now prudent for the City to utilize the five percent exemption for private payments for Target Center Improvements provided that any such improvement remain subject to MCDA approval, and that administrative and cost accounting procedures acceptable to the Finance Officer are used to minimize the risk of future IRS audit conclusions contrary to ours. Many of these procedures are already used in implementing the existing capital improvement program.